



**SOUTH DAKOTA RETIREMENT SYSTEM,
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN,
AND SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN**

**INDEPENDENT AUDITORS' REPORTS
ON AUDITS OF FINANCIAL STATEMENTS
for the year ended June 30, 2009**



**SOUTH DAKOTA RETIREMENT SYSTEM,
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL
RETIREMENT PLAN,
AND SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN**

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Independent Auditors' Report

The Board of Trustees
South Dakota Retirement System:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System (SDRS) as of June 30, 2009, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of SDRS's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SDRS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements present only the financial position and changes in financial position of the State of South Dakota that is attributable to the SDRS. They do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2009, and the changes in its financial position and its cash flows, where applicable, for the fiscal year ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System as of June 30, 2009, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

As explained in note 2 to the financial statements, the financial statements include investments valued at \$1,728,274,069 (31% of net assets) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 16, 2009 on our consideration of SDRS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Management's discussion and analysis on pages 3 through 6, the schedule of funding progress, and schedule of employer contributions on page 25 are not a required part of the basic financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of administrative expenses and investment activity expenses on page 26 and 27 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

Omaha, Nebraska
November 16, 2009

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2009

This section presents management's discussion and analysis of the South Dakota Retirement System's (SDRS or the System) financial position and performance as of and for the year ended June 30, 2009. This section is intended to supplement the SDRS financial statements and should be read in conjunction with the remainder of the SDRS financial statements.

Financial Highlights

- The plan net assets of SDRS decreased by \$1.663 billion during fiscal year 2009. This decrease was primarily due to the investment performance of (20.36)%, which was below the assumed rate of 7.75%.
- SDRS funded ratio decreased to 91.8% in 2009 from 97.2% in 2008.
- SDRS paid \$306.8 million to benefit recipients in fiscal year 2009 compared to \$273.2 million in 2008. SDRS received \$189.7 million in member and employer contributions in fiscal year 2009 compared to \$181.7 million in 2008.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The South Dakota Retirement System presents the statement of the plan net assets as of June 30, 2009 and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of the year-end and sources and uses of those funds during the year.

Notes to the Financial Statements

The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules. Information in the notes provides disclosures concerning SDRS's organization, contributions and reserves, investments, the use of derivatives and securities lending, and other information.

Supplemental Information

In addition to this discussion and analysis, the supplemental information also consists of two schedules of trend data and related notes concerning the funded status of SDRS and employer contributions.

Other supplementary schedules include detailed information on administrative expenses incurred by SDRS and a breakout of investment manager fees.

Financial Analysis

SDRS is a cost-sharing, multiple-employer public employee retirement system. SDRS provides retirement, disability, and survivor benefits for employees of the state of South Dakota and its political subdivisions. The benefits are funded through member and employer contributions and investment income.

SDRS benefits are based on the members' final average compensation, their years of credited service, and a benefit multiplier and are payable for life with a 60% survivor benefit.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2009

A summary of the plan net assets is shown below:

Summary of Plan Net Assets

June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Assets:		
Cash and cash equivalents	\$ 5,308,826	5,963,982
Receivables	28,262,118	60,568,165
Investments, at fair value	5,676,926,340	7,374,351,658
Securities lending collateral	—	321,644,668
Other assets	47,810	45,725
Total assets	<u>5,710,545,094</u>	<u>7,762,574,198</u>
Liabilities:		
Accounts payable and accrued expenses	2,538,567	2,569,051
Securities sold, but not yet purchased	52,023,535	90,627,779
Unsettled investment purchases	6,991,033	35,462,682
Securities lending collateral	—	321,644,668
Due to brokers – futures transactions	224,813	162,557
Total liabilities	<u>61,777,948</u>	<u>450,466,737</u>
Net assets held in trust for pension benefits	<u>\$ 5,648,767,146</u>	<u>7,312,107,461</u>

Funded Ratio

The funded ratio is an actuarial measure of funding progress and soundness for SDRS based on the actuarial accrued liability measurement of liabilities. The ratio is equal to the actuarial value of assets divided by the actuarial accrued liabilities. A ratio in excess of 100% would indicate that the actuarial accrued liability is fully funded.

The actuarial value of assets is equal to the net actuarial value of assets plus the reserve of funding of long-term benefit goals. The net actuarial value of assets is credited each year with the assumed rate of investment return and debited or credited with the SDRS liability gain or loss for the year. The resulting actuarial value of assets is constrained to a range of 80% to 120% of the market value of assets, and the reserve for funding of long-term benefit goals is adjusted if these limits apply.

The actuarial accrued liability is the present value of all benefits currently being paid and expected to be paid in the future, to all members, less the present value of future normal cost contributions.

	<u>2009</u>	<u>2008</u>	<u>Change</u>
Funded ratio	91.8%	97.2%	(5.4)%

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2009

Change in Plan Net Assets

Additions to the plan net assets include member and employer contributions and net investment income (loss). The fixed member and employer contribution rates are established by law. On an annual basis, an independent actuarial valuation of SDRS is made to determine the adequacy of the fixed contribution rates to pay the normal cost of benefits, expenses, and amortize the unfunded actuarial accrued liability. In addition to the fixed contributions, members and employers may make additional contributions to purchase uncredited prior service. These purchase or acquisition payments are also included as contributions. As the SDRS membership ages, the number and amount of purchases have grown.

Income from investments is the other primary source of revenue for SDRS. The actuarial assumed investment rate is 7.75% at June 30, 2009. The investment returns were (20.36)% for 2009 and (8.65)% for 2008.

Deductions from plan net assets are primarily benefit payments. During 2009, SDRS paid \$306 million to benefit recipients or 12% more than 2008. The increase is due to added recipients and the annual 3.1% cost-of-living adjustment. Refunds of accumulated contributions during 2009 decreased 14%. Administrative costs of SDRS represent less than 0.07% of plan net assets.

A summary of the changes in plan net assets is shown below:

	2009	2008	Percentage change
Employee contributions	\$ 95,457,518	91,978,502	3.8%
Employer contributions	94,244,915	89,766,090	5.0
Investment loss	(1,518,619,609)	(723,013,005)	110.0
	<u>(1,328,917,176)</u>	<u>(541,268,413)</u>	<u>145.5</u>
Deductions:			
Benefits	306,769,037	273,236,767	12.3
Refunds of contributions	24,225,249	28,203,655	(14.1)
Administrative expenses	3,428,853	3,352,380	2.3
Total deductions	<u>334,423,139</u>	<u>304,792,802</u>	<u>9.7</u>
Net decrease in plan net assets	(1,663,340,315)	(846,061,215)	96.6
Net assets held in trust for pension benefits:			
Beginning of year	7,312,107,461	8,158,168,676	(10.4)
End of year	<u>\$ 5,648,767,146</u>	<u>7,312,107,461</u>	<u>(22.7)%</u>

Investments

SDRS investment portfolio management is the statutory responsibility of the South Dakota Investment Council. The South Dakota Investment Office is the primary investment manager, but the Investment Council may utilize the services of external money managers.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

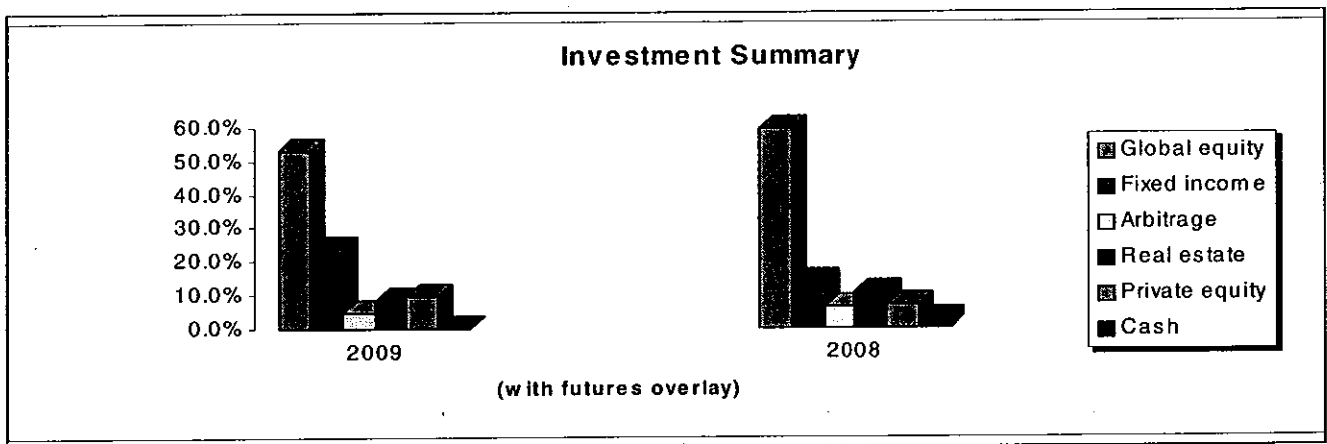
June 30, 2009

Investment performance during 2009 and 2008 was (20.36)% and (8.65)%, respectively.

The Investment Council is governed by the prudent man standard, as defined in South Dakota Codified Law 4-5-27:

4-5-27. Prudent-man standard required in investments. Any investments under the provisions of §4-5-12 to 4-5-39, inclusive, shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Though monthly benefit payments exceed monthly contributions, the SDRS is not subject to sudden, substantial, and unexpected withdrawals. As a result, it is not necessary to maintain a high percentage of assets in short-term investments unless that is deemed to be the best investment strategy. This allows the SDRS trust fund to be fully invested in a diversified portfolio of securities.



Plan Status

While the markets have not always made it possible to achieve the long-term assumptions, the System's funding remains solid. The reserve for long-term benefit goals has provided a process for both improving benefits and protecting the System in down markets.

Requests for Information

Requests for information about SDRS may be directed to the South Dakota Retirement System at P.O. Box 1098, Pierre, SD 57501. You may also contact SDRS online at www.state.sd.us/sdrs/.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Plan Net Assets

June 30, 2009

Assets:

Cash and cash equivalents \$ 5,308,826

Receivables:

Employer 2,030,430

Employee 3,747,237

Benefits 69,328

Unsettled investment sales 5,329,178

Accrued interest and dividends 17,085,945

Total receivables 28,262,118

Investments, at fair value:

Fixed income 1,653,852,882

Equities 3,010,020,431

Real estate 481,769,465

Private equity 531,283,562

Total investments 5,676,926,340

Other assets 47,810

Total assets 5,710,545,094

Liabilities:

Accounts payable and accrued expenses 2,538,567

Securities sold, but not yet purchased, at fair value 52,023,535

Unsettled investment purchases 6,991,033

Due to brokers – futures transactions 224,813

Total liabilities 61,777,948

Net assets held in trust for pension benefits (see schedule of
funding progress) \$ 5,648,767,146

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Changes in Plan Net Assets

Year ended June 30, 2009

Contributions:	
Employee	\$ 95,457,518
Employer	<u>94,244,915</u>
Total contributions	<u>189,702,433</u>
Investment income (loss):	
From investing activities:	
Net depreciation in fair value of investments	(1,658,907,460)
Interest	89,038,929
Dividends	87,597,360
Real estate	<u>4,239,650</u>
Investment loss	<u>(1,478,031,521)</u>
Less investment activity expenses	<u>(40,948,698)</u>
Net investment activity loss	<u>(1,518,980,219)</u>
From securities lending activities:	
Securities lending income	1,620,163
Securities lending expenses	<u>(1,259,553)</u>
Net securities lending activity income	<u>360,610</u>
Total investment loss	<u>(1,518,619,609)</u>
	<u>(1,328,917,176)</u>
Deductions:	
Benefits	306,769,037
Refunds of contributions	24,225,249
Administrative expenses	<u>3,428,853</u>
Total deductions	<u>334,423,139</u>
Net decrease in plan net assets	<u>(1,663,340,315)</u>
Net assets held in trust for pension benefits (see schedule of funding progress):	
Beginning of year	<u>7,312,107,461</u>
End of year	<u>\$ 5,648,767,146</u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

(1) General Description of the System

The South Dakota Retirement System (SDRS) is a cost-sharing, multiple-employer public employee retirement system (PERS) established to provide retirement benefits for employees of the state of South Dakota (the State) and its political subdivisions. Members of SDRS include full-time employees of public schools, the State, the Board of Regents, city and county governments, and other public entities. Public schools, cities, and counties may choose not to include certain full-time employees in the system.

SDRS is considered a part of the State financial reporting entity and is included in the State's financial report as a pension trust fund. Authority for establishing, administering, and amending plan provisions are found in South Dakota Codified Law (SDCL) 3-12.

The South Dakota Retirement System Board of Trustees (the Board) is the governing authority of SDRS. The Board consists of 14 elected representatives from participating groups, two appointees of the governor, and an ex-officio nonvoting representative of the South Dakota Investment Council. The elected representatives of the Board are two teacher members; two State employee members; a participating municipality member; a participating county member; a participating classified employee member; a current contributing Class B member other than a justice, judge, or magistrate judge; a county commissioner of a participating county; a school district board member and an elected municipal official of a participating municipality; a retiree; and a faculty or administrative member employed by the Board of Regents. The two Governor's appointees consist of one head of a principal department established pursuant to SDCL 1-32-2, or one head of a bureau under the office of executive management and one individual from the private or public sector.

SDRS is a hybrid defined benefit plan designed with several defined contribution plan type provisions. The system includes two classes of members: Class A-general members and Class B-public safety and judicial members. Members and their employers make matching contributions, which are defined in State statute. SDRS may expend up to 3% of the annual contributions for administrative expenses subject to approval by the executive and legislative branches of the State.

SDRS provides retirement, disability, and survivor benefits. The right to receive retirement benefits vests after three years of contributory service. Class A members and Class B judicial members who retire after age 65 with three years of service are entitled to an unreduced annual retirement benefit. An unreduced annual retirement benefit is also available after age 55 for Class A members where the sum of age and credited service is equal to or greater than 85 or after age 55 for Class B judicial members where the sum of age and credited service is equal to or greater than 80. Class B public safety members can retire with an unreduced annual retirement benefit after age 55 with three years of contributory service. An unreduced annual retirement benefit is also available after age 45 for Class B public safety members where the sum of age and credited service is equal to or greater than 75. All retirement benefits that do not meet the above criteria may be payable at a reduced level. All benefits receive an annual cost-of-living adjustment of up to 3.1% each July 1st. The first year increase is prorated for the number of months the benefit is received.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

SDRS is a qualified defined benefit retirement plan under Section 401(a) of the Internal Revenue Code and is exempt from Federal income taxes. SDRS last received a favorable determination letter dated August 13, 1996, in which the Internal Revenue Service stated that the System, as then designated, was in compliance with the applicable requirements of the Internal Revenue Code. SDRS has been amended since receiving the determination letter and has requested a new determination letter. SDRS believes that the system currently is designed and being operated in compliance with the applicable requirements of the Internal Revenue Code and, therefore, SDRS continues to be tax-exempt as of June 30, 2009. Therefore, no provision for income taxes has been included in SDRS' financial statements.

SDRS is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors, and omissions; injuries to employees; and natural disasters. SDRS is uninsured for property loss. SDRS participates in the various programs administered by the State of South Dakota (the State). These risk management programs are funded through assessments charged to participating entities. The risk management programs include (1) coverage for risks associated with automobile liability and general tort liability (including public officials' errors and omissions liability, medical malpractice liability, law enforcement liability, and products liability) through the State's Public Entity Pool for Liability Fund, (2) coverage of employee medical claims through the State's health insurance program, (3) coverage for unemployment benefits through the State's Unemployment Insurance Fund, and (4) coverage for workers' compensation benefits through the State's Workers' Compensation Fund. Financial information relative to the self-insurance funds administered by the State is presented in the State of South Dakota Comprehensive Annual Financial Report.

As of June 30, 2009, the number of participating governmental employers is as follows:

School districts	172
State of South Dakota	1
Board of Regents	1
Municipalities	144
Counties	64
Boards and commissions	86
Total employers	<u>468</u>

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

At June 30, 2009, SDRS membership consists of the following:

Retirees and beneficiaries currently receiving benefits:	
Class A (general employees)	18,822
Class B (public safety and judicial employees)	1,127
Total retirees and beneficiaries	19,949
Terminated members entitled to benefits but not yet receiving them:	
Class A (general employees)	13,488
Class B (public safety and judicial employees)	498
Total terminated members	13,986
Current active members:	
Vested:	
Class A (general employees)	28,480
Class B (public safety and judicial employees)	1,988
Nonvested:	
Class A (general employees)	7,490
Class B (public safety and judicial employees)	638
Total current active members	38,596
Grand total	72,531

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting and Presentation

The accompanying financial statements are prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles applicable to governmental accounting for a pension trust fund. Employee and employer contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Pension benefit payments are due the first day of the month following the retirement of a member, and the first of each month thereafter. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and changes therein. Actual results could differ from

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

those estimates. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions.

(b) *Method Used to Value Investments*

Investments are reported at fair value. Equity securities include common stocks, preferred stocks, convertible debentures, arbitrage securities, and equity international funds. The fixed income securities include U.S. government and government-backed bonds and corporate bonds.

The fair value of investments in securities are determined based on closing market prices at June 30, 2009 for those securities traded on national and international stock exchanges and at the average of bid-and-asked quotations for those securities traded in the over-the-counter markets, as available. In general, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. The value of foreign securities in foreign currency amounts is expressed in U.S. dollars at the closing daily rate of exchange. Purchases and sales are recorded as of the trade date.

Alternative investments consist of investments in a variety of markets and industries through partnerships, corporate entities, co-investments, and other investment vehicles. For alternative investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, values these investments in good faith based upon the investment's current financial statements or other information provided by the underlying investment advisor. For all of these alternative investments, SDRS has determined that net asset value reported by the underlying fund approximates the fair value of the investment. These fair value estimates are, by their nature, subjective and based on judgment. These alternative investments were valued at \$1,728,274,069 (31% of net assets) at June 30, 2009. The estimated fair value of these investments may differ significantly from values that would have been used had a ready market existed.

Foreign exchange rate gains and losses are included with the net appreciation in fair value in investments. Futures contracts are marked to market based on quoted futures prices with changes in fair value reflected in the current period.

Interest and dividends are accrued in the period in which they are earned.

(3) Contributions and Reserves

(a) *Contributions*

Covered employees are required by statute to contribute a percentage of their salary to SDRS as follows:

Class A members	6.0% of salary
Class B judicial members	9.0% of salary
Class B public safety members	8.0% of salary

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

All participating employers are required to contribute an amount equal to the members' contributions. Members may make an additional contribution of 1.2% of compensation for optional spouse coverage.

SDRS is funded by fixed member and employer contributions at a rate established by law. On an annual basis, an independent actuarial valuation of SDRS is made to determine the adequacy of the fixed contractually required contributions to pay the normal cost, expenses, and amortize the frozen unfunded actuarial accrued liability. The June 30, 2009 actuarial valuation of the plan determined that the contractually required employer contributions equals the requirements for the annual required contribution of the employers under Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*; the contractually required employer contributions are sufficient to pay the employer normal cost, expenses, and amortize the frozen unfunded actuarial accrued liability over a period of less than 30 years (20 years as of June 30, 2009). The maximum contributions limits are not considered in the projection of pension benefit liabilities. Annual required contributions of the employer equal to the contractually required contributions have been listed below pursuant to GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

	<u>Employer</u>	<u>Percentage contributed</u>
Year ending June 30:		
2009	\$ 94,244,915	100%
2008	89,766,090	100
2007	85,361,762	100

Contributions during fiscal year 2009 totaling \$189,702,433 (\$95,457,518 employee and \$94,244,915 employer) were made in accordance with statutory rates. These contributions represent 13.1% of current year covered payroll for all participating units. The employee contributions exceed the employer contributions because of optional spouse coverage contributions and employee service purchase payments.

SDRS allows participating entities to pay their deferred contributions for funding of accrued benefits over periods of up to 20 years and members to pay for the purchase of certain prior service over periods of up to 10 years. Interest is charged at rates of 5% to 8%.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

Future payments will be received as follows:

Year ending June 30:	<u>Employees</u>
2010	\$ 645,365
2011	454,108
2012	356,123
2013	278,671
2014	210,198
Later	<u>40,596</u>
	1,985,061
Less amount representing interest	<u>285,850</u>
Deferred contributions receivable at June 30, 2009	<u>\$ 1,699,211</u>

(b) Reserves

The reserve for funding of long-term benefit goals is designed to fund benefit improvements and provide the plan with protection against adverse experience. The reserve for funding of long-term benefit goals is equal to the cumulative amounts credited or debited annually based on the immediate recognition of actuarial investment losses, the five-year recognition of actuarial investment gains and the five-year recognition of SDRS liability gains or losses, less reductions described below. If benefit improvements are enacted into law and funded from the reserve for funding of long-term benefit goals, the reserve for funding of long-term benefit goals is reduced by the present value of all benefits for those improvements. The reserve for funding of long-term benefit goals may also be reduced to offset unfavorable experience, if required, to meet the funding objectives of SDRS as established by the Board of Trustees. As of June 30, 2009, the balance in the revenue for funding of long-term benefit goals is \$(2.0 billion).

(4) Funded Status and Funding Progress – Pension Plan

As of June 30, 2009, the most recent actuarial valuation date, the plan was 91.8% funded. The actuarial accrued liability for benefits was \$7.40 billion, and the actuarial value of assets was \$6.78 billion, resulting in an unfunded actuarial accrued liability (UAAL) of \$608.9 million. The covered payroll (annual payroll of active employees covered by the plan) was \$1.45 billion, and the ratio of the UAAL to the covered payroll was 42.0%.

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements on page 25, present multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

In the June 30, 2009 actuarial valuation, the entry age frozen unfunded actuarial accrued liability method was used. The actuarial assumptions included (a) 7.75% investment rate of return and (b) projected salary increases ranging from 4.15% to 8.13%. Both (a) and (b) include the inflation component of 3.1%. The actuarial value of assets was determined by the following method: assets credited with assumed rate of investment return, debited/credited with liability gain/loss for the year and constrained to a range of 80% to 120% of market. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2009 was 20 years.

(5) Cash and Investments

Cash and cash equivalents are held by the State Treasurer and were invested in the state's pooled investment fund. Investments in the state's pooled investment fund consist primarily of commercial paper rated A1 or P2 or better, short-term U.S. Treasury obligations, bank certificates of deposit, and money market funds.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council, which may utilize the services of external money managers for management of a portion of the portfolio. The South Dakota Investment Council is governed by the Prudent Man Rule (that is, the council should use the same degree of care as a prudent man). Current South Dakota Investment Council investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). Below is a detail of the investment balances and amounts managed by the respective fund managers:

	<u>Cost</u>	<u>Fair value</u>
State of South Dakota Investment Council	\$ 4,376,827,620	3,948,956,312
Blackstone Real Estate Partners	593,925,977	342,465,802
Cargill North American Real Estate Partners	157,722,668	92,801,976
CINVIN Fund 4	61,430,668	37,828,860
Research Affiliates	81,422,616	64,823,606
Capital Guardian Global Equity Fund	103,972,210	84,979,411
CVI Global Value Fund	166,768,192	131,511,736
CVI Specialized Ventures Fund	26,270,235	12,705,060
PIMCO Distressed Mtg Fund II	81,680,056	76,960,183
TCW Specialized Mtg Credits	135,371,194	123,201,266
Oaktree Loan Fund 2x	53,038,029	45,140,019
Blackstone Distressed Securities	20,055,848	18,510,360
Blackstone Credit Liquidity	27,966,624	19,995,195
Silver Lake Partners LP	93,754,184	73,476,277
KKR Associates	65,197,095	42,887,657
Cypress Merchant Banking Partners LP	26,802,173	8,960,871
Apollo Real Estate Advisors LP	38,724,182	29,122,002
Bridgewater Pure Alpha Fund II	50,000,000	52,924,648
Dimensional Fund Advisors, Inc.	8,918,381	26,957,592
Blackstone Private Equity	211,259,976	144,075,963
Doughty Hanson & Co. Private Equity IV	87,941,555	70,060,988
Brandes Investment Partners	36,172,888	26,600,200
Lehman Crossroads Investment Advisors LP	15,349,679	11,151,689
Doughty Hanson & Co. European Real Estate	29,152,530	17,379,685
CVC	40,022,638	39,399,508
AIG Capital Partners	15,427,815	11,398,601
Carlyle IV	36,968,502	31,908,334
Riverstone	11,025,047	11,508,488
GE Asset Management	40,920,000	55,686,636
Elevation Partners	23,564,386	20,464,919
DLJ Merchant Banking Partners LP	4,391,930	3,082,496
Total investments	6,722,044,898	5,676,926,340
Securities sold, but not yet purchased	(50,170,520)	(52,023,535)
Total	<u>\$ 6,671,874,378</u>	<u>5,624,902,805</u>

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

(a) Securities Lending

Securities lending transactions are permitted by the Board. These transactions involve the lending of securities to broker-dealers and other entities for collateral in the form of cash or securities, with the simultaneous agreement to return the collateral for the same securities in the future. The securities custodian is an agent in lending securities for collateral of the following percentages:

	<u>Margin required</u>
Collateral type:	
Cash	100%
U.S. government	102
U.S. agencies	102
U.S. sponsored agencies	102
Asset backed (AAA)	105
Corporates (AAA)	110
Money market (A1/P1 – under one year)	102

The cash collateral is reinvested by the lending agent in accordance with contractual investment guidelines that are designed to ensure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers, results in the gross earnings from lending activities, which is then split on a percentage basis with the lending agents.

The contract with the lending agent requires the agent to indemnify the SDRS if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent. The program agreement allows all securities loans to be terminated on demand by either the SDRS or the borrower. The term to maturity of the securities loans is matched with the term to maturity of the investments of the cash collateral by investing in a variety of short-term investments in a segregated collateral investment portfolio.

During the year, SDRS suspended the securities lending program with the lending agent. None of the portfolios had securities on loan at the end of the year. As a result, SDRS had no credit risk exposure to borrowers.

(b) Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are held in the possession of an outside party. SDRS has no formal deposit policy specific to custodial credit risk. At June 30, 2009, SDRS has bank balances in various foreign currencies. These deposits are not collateralized or covered by depository insurance. As a result, \$7,172,242 was exposed to custodial credit risk.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. SDRS has no formal policy for investment custodial credit risk. Collateral securities in the securities lending program are uninsured and unregistered, with the securities held by the counterparty, or by its trust department or agent, but not in SDRS's name. No collateral securities were held at June 30, 2009.

(c) **Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The SDRS's investment grade fixed income portfolio's duration must fall between 70% and 130% of the duration of the Citigroup Broad Investment Grade (BIG) Index. Modified duration estimates the sensitivity of a bond's price to interest rate changes. The durations of the various investment types are listed in the following table:

	<u>Fair value</u>	<u>Duration (in years)</u>
Investment type:		
U.S. Treasuries	\$ 59,182,299	9.13
U.S. Treasury strips	31,759,732	13.81
U.S. Treasury Bills	3,598,808	0.22
U.S. agencies	51,777,058	5.08
Investment grade corporates	275,408,884	3.35
High-yield corporates	239,129,894	3.79
Mortgage-backed securities	318,638,023	2.93
Mutual funds	103,043,618	—
FDIC Temporary Liquidity Guarantee Program	28,773,218	3.13
Total	<u>\$ 1,111,311,534</u>	

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

(d) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SDRS. The South Dakota Investment Council sets the investment policy annually for the SDRS. This policy establishes the average percentage invested in each asset category and the fund allocation range that each asset category can vary during the fiscal year. As of June 30, 2009, the portfolios held the following investments, excluding those issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service.

	<u>Fair value</u>
Moody's rating:	
Aaa	\$ 422,461,986
Aa	23,350,976
A	111,384,258
Baa	98,287,204
Ba	112,753,354
B	60,878,518
Caa	19,845,768
Ca	—
C	—
Not rated	<u>88,038,701</u>
Total	<u>\$ 937,000,765</u>

(e) Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of SDRS' investment in a single issuer. SDRS does not have guidelines to limit its investments in any particular investment. SDRS does not have investments in any one issuer that represent 5% or more of the total fair value of investments as of June 30, 2009 (excluding those issued by or explicitly guaranteed by the U.S. Government).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

(f) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SDRS's exposure to foreign currency risk derives from its positions in foreign currency and foreign-currency-denominated equity and fixed income investments. SDRS does not hedge foreign currency back to U.S. dollars (to match the unhedged benchmark), but does allow hedging under certain circumstances, when deemed appropriate. The portfolio's exposure to foreign currency risk at June 30, 2009 is as follows (in U.S. dollar fair value):

	Equities U.S. dollar fair value	Fixed income U.S. dollar fair value	Cash U.S. dollar fair value	Total
Currency:				
Australian Dollar	\$ 1,849,842	—	9,084	1,858,926
Brazilian Real	1,209,732	—	—	1,209,732
British Pound	136,323,902	—	2,214,006	138,537,908
Canadian Dollar	49,568,988	—	85,600	49,654,588
Danish Kroner	163,951	—	32,186	196,137
Euro	269,075,169	—	4,192,685	273,267,854
Hong Kong Dollar	3,127,002	—	22,174	3,149,176
Japanese Yen	133,235,996	—	516,969	133,752,965
Korean Won	8,726,965	—	—	8,726,965
Malaysian Ringgit	247,319	—	—	247,319
New Zealand Dollar	436,982	—	—	436,982
Norwegian Krone	3,709,638	—	1	3,709,639
South African Rand	298,979	—	—	298,979
Swedish Krona	3,628,058	—	58,602	3,686,660
Swiss Franc	92,832,459	—	40,935	92,873,394
Turkish Lira	923,304	—	—	923,304
Total fair value	<u>\$ 705,358,286</u>	<u>—</u>	<u>7,172,242</u>	<u>712,530,528</u>

Investments with limited partnerships and certain global equity investments with outside managers, which are not included in the table above, may expose SDRS's portfolio to additional foreign currency risk. The total fair value of investments in real estate and private equity limited partnerships as of June 30, 2009 was \$987,974,116. The total fair value of global equity, arbitrage equity, and distressed and high yield fixed income investments managed by outside managers was \$363,601,589, \$79,882,240, and \$296,512,083, respectively.

(g) Return on Investments

During fiscal year 2009, SDRS's investments (including investments bought and sold, as well as held during the year) depreciated in value by \$1,658,907,460.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior years and current year.

Change in Fair Value of Investments	
Depreciation in fair value of investments:	
Equities	\$ (317,391,442)
Fixed income	(49,029,523)
Real estate	(507,899,762)
Private equity	(271,171,443)
Total decrease in fair value	<u>(1,145,492,170)</u>
Realized gain (loss) on investments sold:	
Equities	(605,124,978)
Fixed income	(6,515,667)
Real estate	(7,444,942)
Private equity	3,891,357
Total net realized losses	<u>(615,194,230)</u>
Net gain on futures contracts	<u>101,778,940</u>
Net depreciation in fair value of investments	<u>\$ (1,658,907,460)</u>

(6) Derivatives

Derivatives are generally defined as contracts whose value depends on, or derives from, the value of an underlying asset, reference rate, or index. SDRS is exposed to a variety of derivative products through the investment management of the South Dakota Investment Council and its outside managers.

The South Dakota Investment Council purchases and sells financial, interest rate and commodity futures as a means of adjusting the SDRS portfolio mix and as a lower transaction cost substitute for transactions that would otherwise occur in the underlying portfolios. Futures contracts outstanding at June 30, 2009 are as follows:

	<u>Open position</u>	<u>Number of contracts</u>	<u>Value covered by contracts</u>
S&P 500 Index due September 17, 2009	Long	140	\$ 32,176,200
U.S. Treasury note due September 21, 2009	Long	135	20,214,975

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

A futures contract is a contract to buy or sell units of an index, financial instrument, or commodities at a specified future date at a price agreed upon when the contract is originated. Upon entering into such a contract, SDRS pledges to the broker cash or U.S. government securities equal to the minimum "initial margin" requirement of the futures exchange. Additionally, SDRS receives or pays a daily "variation margin," which is an amount of cash equal to the daily fluctuation in value of the contract. The use of futures contracts is subject to various market risks. The maximum amount at risk from the purchase (long position) of a futures contract is the contract value. The amount at risk from the sale (short position) of a futures contract depends upon the amount that the contract raises in value. Although short positions have theoretically no maximum risk, the SDRS short positions are hedged against the underlying portfolio to limit the exposure.

The hedging guidelines of the SDRS arbitrage portfolios managed by the South Dakota Investment Council provide that stock and other noncash considerations to be received may be hedged. The two arbitrage portfolios had short sales valued at \$52,023,535 as of June 30, 2009. A short sale involves the sale of securities not yet owned, but borrowed through a broker to be later repurchased to cover the loan. The arbitrage portfolios use the short sales to hedge the disparities between the existing price of a security and the present value of considerations to be received as a result of restructuring or merger activity.

The South Dakota Investment Council also enters into foreign exchange forward contracts to hedge foreign currency transactions. These contracts are purchased to reduce the impact of foreign currency fluctuations. The South Dakota Investment Council does not engage in foreign currency speculation. The contracts do not subject SDRS to risk due to exchange rate movements as gains and losses on the contracts offset gains and losses on the transactions being hedged. The unrealized loss on foreign exchange forward contracts as of June 30, 2009 was \$4,609,838. This amount does not include limited partnerships and certain global equity investments with outside managers, which may also enter into foreign exchange forward contracts.

SDRS's theoretical risk in these transactions is the cost of replacing, at current market rates, these contracts in the event of default by the other party. Management believes the risk of incurring such losses is remote as the contracts are entered into with major financial institutions.

In addition to the derivatives listed above, the SDRS fixed income portfolio also held mortgage-backed securities in the form of GNMA's, FHLMC's, and FNMA's. The fair value of these securities as of June 30, 2009 was \$317,253,682. These securities may be subject to prepayment by the mortgagees, which may reduce the fair value of these securities. The South Dakota Investment Council is using this investment to enhance fixed income returns. Details regarding the interest rate risks for these investments are included with the interest rate risk disclosures above.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

(7) Compensated Absences

Annual leave is earned by all SDRS employees. Upon termination, SDRS employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2009, a liability existed for accumulated annual leave calculated at the employees' June 30, 2009 pay rate in the amount of \$115,179. Employees who have been continuously employed by SDRS and the State for at least seven years prior to the date of their retirement, voluntary resignation, or death will receive payment for one-fourth of their accumulated sick leave balance with such payment not to exceed the sum of 12 weeks of the employee's annual compensation. For employees who have not been employed for seven continuous years, an accrued liability is calculated assuming the likelihood that they will meet the seven-year threshold in the future. At June 30, 2009, a liability existed for accumulated and accrued sick leave, calculated at the employees' June 30, 2009 pay rate in the amount of \$129,635.

	<u>2009</u>	<u>2008</u>	<u>Percentage change</u>
Total compensated absences	\$ 244,814	229,391	6.72%

The total leave liability for the current year is on the statement of net assets available for benefits in accounts payable and accrued expenses.

(8) Operating Leases

The SDRS has entered into an agreement to lease office space. The lease was effective September 2007 and has a term of five years. A schedule of minimum office rental payments as of June 30, 2009 is as follows for the fiscal year ending June 30:

2010	\$	105,389
2011		105,389
2012		<u>105,389</u>
Total remaining minimum payments	\$	<u><u>316,167</u></u>

(9) Supplemental Retirement Plan

SDRS offers a deferred compensation plan known as the Supplemental Retirement Plan (SRP), created in accordance with Internal Revenue Code Section 457. SRP is available to all public employees and permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseen emergency.

All amounts of compensation deferred under the SRP, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are at all times held in trust for the exclusive benefit of the participants until made available to a participant or the participant's beneficiary.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2009

Of the \$111,809,479 net assets available for plan benefits at June 30, 2009, \$69,856,319 was held in trust for employees of the State, while the remaining \$41,953,160 represents the assets held in trust for employees of other jurisdictions. In order to avoid duplication in reporting, the SDRS total of \$507,589 is included in the State total and the State's comprehensive annual financial report for the year ended June 30, 2009.

(10) Special Pay Plan

The Special Pay Plan (SPP) was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the SDRS Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the plan. The SPP mandates that qualifying employees (over age 55 and \$2,000 or more in special pay) of participating units defer 100% of their special lump-sum termination pay to the plan. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

Of the \$16,096,014 net assets available for plan benefits at June 30, 2009, \$9,277,490 was held in trust for employees of the State, while the remaining \$6,818,524 represents the assets held in trust for employees of other jurisdictions.

(11) Plan Termination

SDRS is administered in accordance with South Dakota statutes. The statutes provide for full vesting in accrued benefits upon termination of the plan (SDCL 3-12-72.2).

(12) Commitments

At June 30, 2009, SDRS had uncalled capital commitments to private equity limited partnerships totaling approximately \$495,182,689 and to real estate limited partnerships totaling approximately \$491,163,094. The commitments may be called at the discretion of the general partner or may never be called. As capital is called, it is funded from capital and earnings returned by the limited partnerships or from other assets.

SOUTH DAKOTA RETIREMENT SYSTEM

Required Supplementary Information

June 30, 2009

Schedule of Funding Progress (Dollar amounts in millions)						
Actuarial valuation date	(a) Actuarial value of assets	(b) Actuarial accrued liability – entry age (AAL)	Unfunded actuarial accrued liability (UAAL) (b-a)	Funded ratio (a/b)	(c) Covered payroll	UAAL as a percentage of covered payroll ((b-a)/c)
6/30/2004	\$ 4,937.5	5,051.7	114.2	97.7%	\$ 1,164.0	9.8%
6/30/2005	5,381.0	5,571.8	190.8	96.6	1,206.1	15.8
6/30/2006	5,668.5	5,859.9	191.4	96.7	1,229.9	15.6
6/30/2007	6,526.5	6,718.8	192.3	97.1	1,297.3	14.8
6/30/2008	6,784.3	6,976.8	192.5	97.2	1,363.9	14.1
6/30/2009	6,778.5	7,387.4	608.9	91.8	1,450.7	42.0

Schedule of Employer Contributions Last Six Years		
Year ended June 30:	Annual required contributions	Percentage contributed
2004	\$ 74,854,496	100%
2005	77,474,967	100
2006	80,829,338	100
2007	85,361,762	100
2008	89,766,090	100
2009	94,244,915	100

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2009	Actuarial assumptions:	
Actuarial cost method	Entry age with frozen unfunded actuarial accrued liability	Investment rate of return *	7.75%
Amortization method	Level percentage-open	Projected salary increase *	4.15% to 8.13%
Remaining amortization period	20 years	based on age, with average of 5.5%	
Asset valuation method	Assets credited with assumed rate of investment return, debited/credited with liability gain/loss for the year, and constrained to a range of 80% to 120% of market	Cost of living adjustments	3.1%
		* Includes inflation at 4%	

See accompanying independent auditors' report.

SOUTH DAKOTA RETIREMENT SYSTEM

Supplementary Information

June 30, 2009

Schedule of Administrative Expenses	
Year ended June 30, 2009	
Personal services:	
Salary and per diem	\$ 1,379,472
Employee benefits	<u>360,879</u>
Total personal services	<u>1,740,351</u>
Operating expenses:	
Travel	61,536
Contractual services:	
Finance	104,366
Valuations	104,498
Consulting	91,922
Studies	79,162
Special Studies	40,339
Legal	4,779
Communications	62,459
Medical	13,353
Operations	<u>835,987</u>
Total contractual services	1,336,865
Supplies and materials	244,548
Capital assets	<u>45,553</u>
Total operating expenses	<u>1,688,502</u>
Total administrative expenses	<u>\$ 3,428,853</u>

SOUTH DAKOTA RETIREMENT SYSTEM

Supplementary Information

June 30, 2009

Schedule of Investment Activity Expenses Year ended June 30, 2009

Investment managers:

State of South Dakota Investment Council	\$ 5,123,848
AIG	652,378
Alliance Bernstein Global Strategic Fund	183,338
Apollo Real Estate Advisors LP	218,438
Blackstone Distressed Debt	571,935
Blackstone Private Equity	2,790,484
Blackstone Real Estate Partners	9,728,019
Brandes Investment Partners	258,181
Capital International	1,057,291
Cargill North American Real Estate Partners	1,922,306
Carlyle	709,840
CINVIN	2,450,361
CVC	1,226,269
CVI	2,880,543
Cypress Merchant Banking Partners LP	187,301
Dimensional Fund Advisors, Inc.	107,519
Doughty Hanson & Co. European Real Estate	1,662,386
Doughty Hanson & Co. Private Equity IV	1,805,738
Elevation Partners	730,457
GE Asset Management China	711,227
KKR Associates	393,026
Lehman Crossroads Investment Advisors LP	412,147
Oaktree Loan Fund 2x	387,142
PIMCO Distressed Mtg Fund II	320,716
Post Advisory Group LLC	4,387
Research Affiliates	116,714
Riverstone	578,927
Silver Lake Partners LP	2,242,691
TCW Specialized Mtg Credits	1,515,089
Total investment manager expenses	<u>\$ 40,948,698</u>

See accompanying independent auditors' report.

SOUTH DAKOTA RETIREMENT SYSTEM

Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards*

June 30, 2009



KPMG LLP
Suite 1501
Two Central Park Plaza
Omaha, NE 68102

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
South Dakota Retirement System:

We have audited the financial statements of South Dakota Retirement System (SDRS) as of and for the year ended June 30, 2009, and have issued our report thereon dated November 16, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered SDRS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of SDRS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SDRS's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SDRS's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and management and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

KPMG LLP

Omaha, Nebraska
November 16, 2009

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Financial Statements

June 30, 2009

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1501
Two Central Park Plaza
Omaha, NE 68102

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

Independent Auditors' Report

The Board of Trustees
South Dakota Retirement System
Supplemental Retirement Plan:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) as of June 30, 2009, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System Supplemental Retirement Plan as of June 30, 2009, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 16, 2009, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Management's discussion and analysis on pages 32 through 35, is not a required part of the basic financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Omaha, Nebraska
November 16, 2009

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2009

This section presents management's discussion and analysis of the South Dakota Retirement System Supplemental Retirement Plan's (SRP or the Plan) financial position and performance for the year ended June 30, 2009. This section is intended to supplement the SRP financial statements.

Financial Highlights

- The net assets available for plan benefits of the SRP decreased by \$12.2 million during fiscal year 2009. This decrease was primarily attributable to investment losses and distributions to participants.
- The SRP paid \$4.8 million to benefit recipients in fiscal year 2009 compared to \$6.3 million in 2008. The SRP received \$12.1 million in contributions in fiscal year 2009 compared to \$18.0 million in 2008. SRP had a \$25 incentive payment for every new account, which added 855 new members in fiscal year 2009.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The South Dakota Retirement System Supplemental Retirement Plan presents the statement of plan net assets as of June 30, 2009, and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

Notes to the Financial Statements

The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

Financial Analysis

The SRP was established in accordance with Internal Revenue Code Section 457 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and recordkeeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SRP benefits are based on the participant balances in the Plan.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2009

A summary of the net assets held in trust for plan benefits is shown below:

Summary of Plan Net Assets

June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Assets:		
Investments, at fair value	\$ 111,275,660	123,338,250
Cash	151,627	200,820
Accrued interest	9,676	11,426
Contributions receivable	<u>398,031</u>	<u>516,574</u>
Total assets	111,834,994	124,067,070
Liabilities:		
Accounts payable	<u>25,515</u>	<u>28,264</u>
Net assets held in trust for plan benefits	<u>\$ 111,809,479</u>	<u>124,038,806</u>

Change in Plan Net Assets

Additions to the net assets include contributions and net investment income (loss). Deductions from net assets are primarily benefit payments. During 2009, SRP paid \$4.8 million to benefit recipients, or 23.1% less than 2008.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

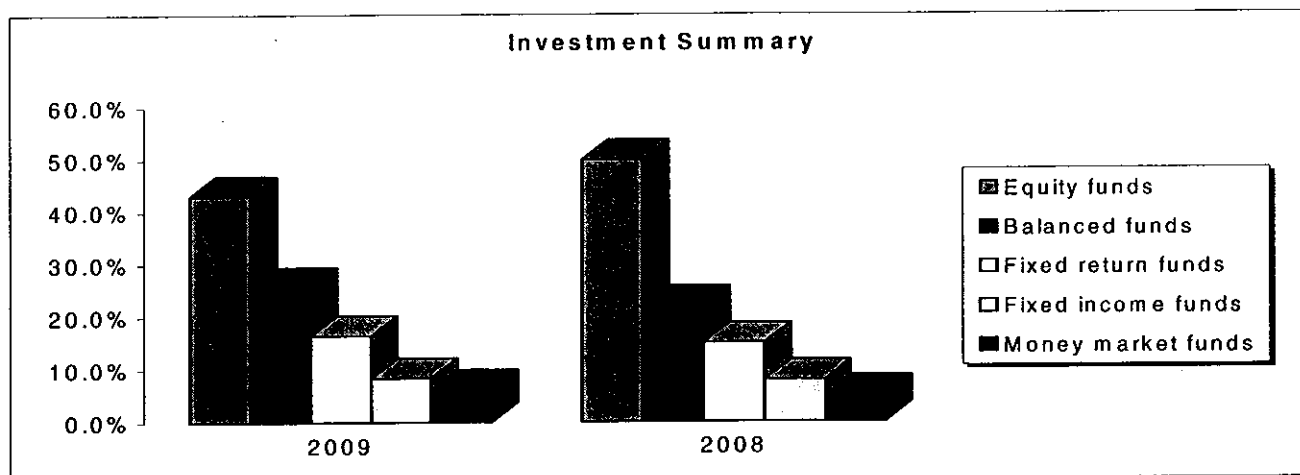
June 30, 2009

A summary of the changes in plan net assets is shown below:

	2009	2008	Percentage change
Contributions – employee	\$ 12,142,599	18,076,567	(32.8)%
Investment loss	(19,247,318)	(11,093,782)	73.5
	(7,104,719)	6,982,785	(201.7)
Deductions:			
Distributions to participants	4,847,929	6,302,958	(23.1)
Administrative expenses	276,679	365,736	(24.4)
Transfers to related plan	—	282,179	(100.0)
Total deductions	5,124,608	6,950,873	(26.3)
Net (decrease) increase in plan net assets	(12,229,327)	31,912	(38,422.0)
Net assets held in trust for pension benefits:			
Beginning of year	124,038,806	124,006,894	0.03
End of year	\$ 111,809,479	124,038,806	(9.9)%

Investments

The selection of SRP investment portfolio alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SRP fund types.



**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Management's Discussion and Analysis

June 30, 2009

Requests for Information

Requests for information about the SRP may be directed to the Supplemental Retirement Plan at 207 East Capitol Avenue, P.O. Box 944, Pierre, SD 57501. You may reach the SRP at (605) 224-2230, 1-800-959-4457, or online at www.srp457.com. You may link to the SRP Web site from the SDRS Web site at www.state.sd.us/sdrs/.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Statement of Plan Net Assets

June 30, 2009

Assets:

Investments, at fair value:

Equity funds	\$ 48,310,133
Balanced funds	28,227,491
Fixed return funds	18,411,084
Fixed income funds	9,377,341
Money market funds	<u>6,949,611</u>

Total investments, at fair value 111,275,660

Cash	151,627
Accrued interest	9,676
Contributions receivable	<u>398,031</u>

Total assets 111,834,994

Liabilities:

Accounts payable	<u>25,515</u>
------------------	---------------

Net assets held in trust for plan benefits \$ 111,809,479

Statement of Changes in Plan Net Assets

Year ended June 30, 2009

Contributions - employee	\$ 12,142,599
Investment loss	<u>(19,247,318)</u>
	<u>(7,104,719)</u>

Deductions:

Distributions to participants	4,847,929
Administrative expenses	<u>276,679</u>

Total deductions 5,124,608

Net decrease in plan net assets (12,229,327)

Net assets held in trust for plan benefits:

Beginning of year	<u>124,038,806</u>
End of year	\$ <u>111,809,479</u>

See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2009

(1) Plan Description

The following description of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

(a) General

The Plan was established in July 1987 in accordance with Internal Revenue Code Section 457 under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The state of South Dakota is a participating unit and every political subdivision thereof may become a participating unit in the Plan. The Plan permits employees of participating units to defer a portion of their salary until future years. The deferred compensation is not available to the participants until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary, shall be held in trust for the exclusive benefit of the participant.

(b) Contributions

Participants of the Plan may contribute an amount of not less than \$25 per month and not in excess of \$16,500 for calendar year 2009 or 100% of includable compensation. A participant may make a one-time election to defer an additional amount of twice the otherwise applicable limit during any of the three calendar years immediately preceding a participant's elected normal retirement age. If age 50 or over, participants may also defer additional contributions of \$5,000.

(c) Participant's Account

Each participant's account is credited with the participant's contributions, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

(d) Distribution to Participants

Distributions of benefits to participants can be made upon termination, retirement, death, or unforeseeable emergency. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or installments, as defined in the plan agreement.

(e) Vesting

Participants are vested immediately in their contributions plus actual earnings thereon.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2009

(f) *Risks and Uncertainties*

The Plan invests in various investment securities. These securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of plan net assets.

(2) *Summary of Significant Accounting Policies*

(a) *Basis of Accounting*

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the plan.

(b) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(3) *Investments*

Investments are carried at fair value based upon quoted market prices at June 30, 2009, as available. Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury bills, certificates of deposit, commercial paper, and bankers' acceptances issued by major U.S. banks. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of U.S. and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20% of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2009

Changes in plan net assets for the year ended June 30, 2009 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income (loss)	Deductions	Transfers to/from related plan	Internal transfers	Ending balance	Market value as a percentage of plan assets
Money market:								
Vanguard Prime Reserve	\$ 8,345,011	781,982	128,921	(2,306,303)	—	—	6,949,611	6.2%
Balanced:								
Vanguard Target Ret Inc Func	1,706,278	52,880	(106,882)	(212,351)	—	—	1,439,925	1.3
Vanguard Target Ret 2005	2,997,801	121,088	(285,755)	(312,889)	—	—	2,520,245	2.3
Vanguard Target Ret 2010	5,618,304	405,411	(690,648)	(182,354)	—	—	5,150,713	4.6
Vanguard Target Ret 2015	7,972,793	843,528	(1,167,464)	(480,890)	—	—	7,167,967	6.4
Vanguard Target Ret 2020	6,156,539	754,417	(1,054,009)	(150,676)	—	—	5,706,271	5.1
Vanguard Target Ret 2025	3,193,293	415,519	(675,311)	(78,811)	—	—	2,854,690	2.6
Vanguard Target Ret 2030	2,395,025	305,011	(520,315)	(49,176)	—	—	2,130,545	1.9
Vanguard Target Ret 2035	455,410	198,484	(100,479)	25,413	—	—	578,828	0.5
Vanguard Target Ret 2040	243,546	109,181	(54,627)	(633)	—	—	297,467	0.3
Vanguard Target Ret 2045	147,219	57,905	(31,621)	34,370	—	—	207,873	0.2
Vanguard Target Ret 2050	115,322	114,642	(29,760)	(27,237)	—	—	172,967	0.2
	<u>31,001,530</u>	<u>3,378,066</u>	<u>(4,716,871)</u>	<u>(1,435,234)</u>	<u>—</u>	<u>—</u>	<u>28,227,491</u>	<u>25.4</u>
Fixed return:								
Prudential	14,881,656	1,719,458	661,074	1,148,896	—	—	18,411,084	16.5
Fixed income:								
Vanguard Bond Market	8,177,869	859,552	523,583	(183,663)	—	—	9,377,341	8.4
Equity:								
Mutual shares	11,500,255	744,591	(2,675,420)	(728,509)	—	—	8,840,917	7.9
Windsor II Adm	16,301,117	1,033,398	(3,932,243)	(1,157,079)	—	—	12,245,193	11.0
Vanguard Inst Index	15,118,070	1,106,828	(3,884,842)	(140,058)	—	—	12,199,998	10.9
Vanguard Tot Int'l	7,636,422	728,260	(2,334,937)	(615,829)	—	—	5,413,916	4.8
Alliance Bern with App St	239,897	52,684	(85,499)	8,184	—	—	215,266	0.2
Dodge&Cox Int Stock Fund	993,449	195,989	(294,164)	(73,749)	—	—	821,525	0.7
Legg Mason Opp Fund	332,802	73,747	(120,149)	52,747	—	—	339,147	0.3
Legg Mason Value Trust	272,522	74,419	(84,622)	54,207	—	—	316,526	0.3
Growth fund of America	1,804,261	555,650	(530,113)	266,993	—	—	2,096,791	1.9
Capital World Grth & Inc	1,088,728	346,388	(287,949)	40,428	—	—	1,187,595	1.1
Vanguard Ext Mkt Idx Fund	5,228,951	500,606	(1,476,159)	(121,361)	—	—	4,132,037	3.7
Vanguard Strategic Equity	415,710	170,143	(147,604)	62,973	—	—	501,222	0.4
	<u>60,932,184</u>	<u>5,582,703</u>	<u>(15,853,701)</u>	<u>(2,351,053)</u>	<u>—</u>	<u>—</u>	<u>48,310,133</u>	<u>43.2</u>
Total investments	<u>123,338,250</u>	<u>12,321,761</u>	<u>(19,256,994)</u>	<u>(5,127,357)</u>	<u>—</u>	<u>—</u>	<u>111,275,660</u>	<u>99.5</u>
Other plan net assets	<u>700,556</u>	<u>(179,162)</u>	<u>9,676</u>	<u>2,749</u>	<u>—</u>	<u>—</u>	<u>533,819</u>	<u>0.5</u>
Total plan net assets	<u>\$ 124,038,806</u>	<u>12,142,599</u>	<u>(19,247,318)</u>	<u>(5,124,608)</u>	<u>—</u>	<u>—</u>	<u>111,809,479</u>	<u>100.0%</u>

(4) Plan Administration

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Notes to Financial Statements

June 30, 2009

(5) Federal Income Tax Status

The Plan is an eligible nonqualified deferred compensation plan under Section 457(a) of the Internal Revenue Code and is exempt from Federal income taxes. The Plan has received a favorable determination letter dated September 15, 1988. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

(6) Transfers to Related Plan

During the year, no assets were transferred from the Plan into the South Dakota Retirement System Special Pay Plan (SPP), a related plan. Transfers between SRP and SPP are allowed under state statutes.

(7) Plan Termination

Although they have not expressed any intent to do so, the South Dakota Retirement Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants continue to be 100% vested in their account balances.

**SOUTH DAKOTA RETIREMENT SYSTEM
SUPPLEMENTAL RETIREMENT PLAN**

Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed In Accordance
with *Government Auditing Standards*

June 30, 2009



KPMG LLP
Suite 1501
Two Central Park Plaza
Omaha, NE 68102

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
South Dakota Retirement System
Supplemental Retirement Plan:

We have audited the financial statements of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) as of and for the year ended June 30, 2009, and have issued our report thereon dated November 16, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



This report is intended solely for the information and use of the Board of Trustees, State of South Dakota Department of Legislative Audit, and management and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

KPMG LLP

Omaha, Nebraska
November 16, 2009

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Financial Statements

June 30, 2009

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1501
Two Central Park Plaza
Omaha, NE 68102

Suite 1600
233 South 13th Street
Lincoln, NE 68508-2041

Independent Auditors' Report

The Board of Trustees
South Dakota Retirement System
Special Pay Plan:

We have audited the accompanying statement of plan net assets of the South Dakota Retirement System Special Pay Plan (the Plan) as of June 30, 2009, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Retirement System Special Pay Plan as of June 30, 2009, and the changes in its plan net assets for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 16, 2009 on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Management's discussion and analysis on pages 45 through 47 is not a required part of the basic financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Omaha, Nebraska
November 16, 2009

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

June 30, 2009

This section presents management's discussion and analysis of the South Dakota Retirement System Special Pay Plan's (SPP or the Plan) financial position and performance for the year ended June 30, 2009. This section is intended to supplement the SPP financial statements and notes.

Financial Highlights

- The net assets available for plan benefits of the SPP increased by \$2.4 million during fiscal year 2009. This increase was primarily attributable to participant contributions.
- The SPP paid \$3.2 million to benefit recipients in fiscal year 2009 compared to \$3.7 million in 2008. The SPP received \$5.8 million in contributions in fiscal year 2009 compared to \$5.6 million in 2008.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The South Dakota Retirement System Special Pay Plan presents the statement of plan net assets as of June 30, 2009, and the statement of changes in plan net assets for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

Notes to the Financial Statements

The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

Financial Analysis

The SPP was established in accordance with Internal Revenue Code Section 401 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and recordkeeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SPP benefits are based on the participant balances in the Plan.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Management's Discussion and Analysis

June 30, 2009

A summary of the net assets held in trust for plan benefits is shown below:

Summary of Plan Net Assets

June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Assets:		
Investments, at fair value	\$ 15,688,304	12,456,792
Cash	66,516	395,833
Accrued interest	692	1,458
Contributions receivable	<u>344,597</u>	<u>829,858</u>
Total assets	16,100,109	13,683,941
Liabilities:		
Accounts payable	<u>4,095</u>	<u>9,153</u>
Net assets held in trust for plan benefits	<u>\$ 16,096,014</u>	<u>13,674,788</u>

Changes in Plan Net Assets

Additions to the net assets mainly were due to contributions during the year. Deductions from net assets are primarily benefit payments and investment losses. During 2009, SPP paid \$3.2 million to benefit recipients, or 12.4% less than 2008.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

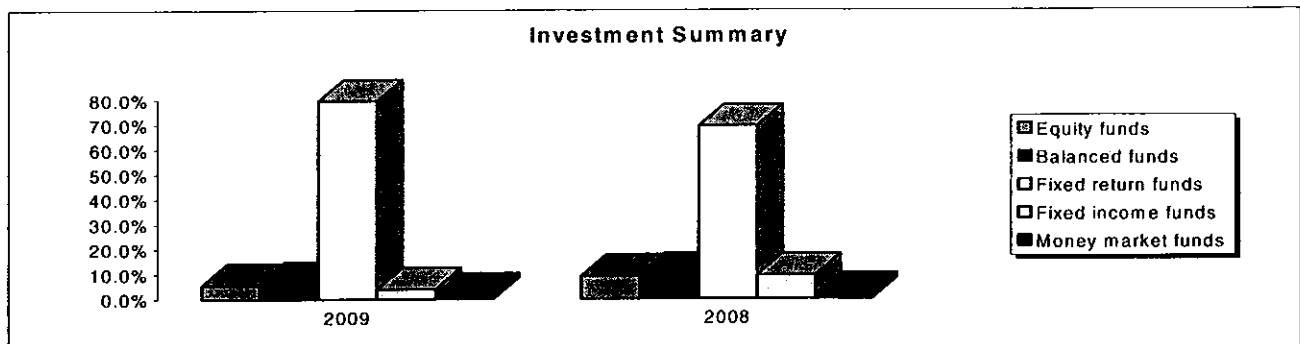
June 30, 2009

A summary of the changes in plan net assets is shown below:

	2009	2008	Percentage change
Contributions – employee	\$ 5,811,813	5,550,770	4.7%
Investment loss	(180,147)	(1,039)	17,238.5
Other income	24,120	24,283	(0.7)
Transfers from/to related plan	—	282,179	(100.0)
	<u>5,655,786</u>	<u>5,856,193</u>	<u>(3.4)</u>
Deductions:			
Distributions to participants	3,210,440	3,666,670	(12.4)
Administrative expenses	24,120	21,375	12.8
Total deductions	<u>3,234,560</u>	<u>3,688,045</u>	<u>(12.3)</u>
Net increase in plan net assets	2,421,226	2,168,148	11.7
Net assets held in trust for pension benefits:			
Beginning of year	13,674,788	11,506,640	18.8
End of year	<u>\$ 16,096,014</u>	<u>13,674,788</u>	<u>17.7%</u>

Investments

The selection of SPP investment portfolio alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SPP fund types.



Requests for Information

Requests for information about the SPP may be directed to the Special Pay Plan at 207 East Capitol Avenue, P.O. Box 944, Pierre, SD 57501. You may reach the SPP at (605) 224-2230 or 1-800-959-4457.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Statement of Plan Net Assets

June 30, 2009

Assets:

Investments, at fair value:

Equity funds	\$ 1,264,524
Balanced funds	1,050,939
Fixed return funds	12,841,926
Fixed income funds	241,321
Money market funds	289,594

Total investments, at fair value	15,688,304
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Cash	66,516
Accrued interest	692
Contributions receivable	344,597

Total assets	16,100,109
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Liabilities:

Accounts payable	4,095
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Net assets held in trust for plan benefits	\$ 16,096,014
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Statement of Changes in Plan Net Assets

Year ended June 30, 2009

Contributions – employee	\$ 5,811,813
Investment loss	(180,147)
Other income	24,120
	5,655,786

Deductions:

Distributions to participants	3,210,440
Administrative expenses	24,120

Total deductions	3,234,560
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Net increase in plan net assets	2,421,226
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Net assets held in trust for plan benefits:

Beginning of year	13,674,788
End of year	\$ 16,096,014

See accompanying notes to financial statements.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Notes to Financial Statements

June 30, 2009

(1) Plan Description

The following description of the South Dakota Retirement System Special Pay Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

(a) General

The Plan was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the South Dakota Retirement System Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the Plan. The Plan mandates that qualifying employees (over age 55 and \$2,000 or more in special pay) of participating units defer 100% of their special lump-sum termination pay to the plan. Special pay is compensation other than regular salary or wages granted to a member of the South Dakota Retirement System and transferred in a sum to the Plan at termination of the member's employment. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

All amounts of special termination pay deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary for estate, shall be held in trust for the exclusive benefit of the participant.

(b) Contributions

Participants in the Plan can contribute the lesser of 100% of their one-time, lump-sum special pay associated with their termination or \$49,000 for calendar year 2009.

(c) Participant's Account

Each participant's account is credited with the participant's contribution, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

(d) Distribution to Participants

Distributions of benefits to participants can be made immediately after the participant's termination, or upon the participant's retirement, or to a beneficiary or an estate upon the participant's death. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or in the form of installments as defined in the plan agreement.

**SOUTH DAKOTA RETIREMENT SYSTEM
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June 30, 2009

(e) *Risks and Uncertainties*

The Plan invests in various investment securities. These securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of plan net assets.

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting*

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the plan.

(b) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(3) Investments

Investments are carried at fair value based upon quoted market prices at June 30, 2009, as available. Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury bills, certificates of deposit, commercial paper, and bankers' acceptances issued by major U.S. banks. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of U.S. and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20% of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

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June 30, 2009

Changes in plan net assets for the year ended June 30, 2009 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment income (loss)	Transfers to/from related plan	Deductions	Internal transfers	Ending balance	Market value as a percent plan assets
Money market:								
Vanguard prime reserve	\$ 338,628		5,523	—	(54,557)	—	289,594	1.8%
Balanced:								
Vanguard Target Ret Inc	31,345	11,322	(2,458)	—	(2,925)	—	37,284	0.2
Vanguard Target Ret 2005	20,692	—	(1,844)	—	(90)	—	18,758	0.1
Vanguard Target Ret 2010	535,069	517	(65,584)	—	(322)	—	469,680	2.9
Vanguard Target Ret 2015	611,241	823	(90,688)	—	(3,935)	—	517,441	3.2
Vanguard Target Ret 2045	10,287	—	(2,421)	—	(90)	—	7,776	—
	<u>1,208,634</u>	<u>12,662</u>	<u>(162,995)</u>	<u>—</u>	<u>(7,362)</u>	<u>—</u>	<u>1,050,939</u>	<u>6.4</u>
Fixed return:								
Prudential	8,935,764	6,571,910	440,115	—	(3,105,863)	—	12,841,926	79.8
Fixed income:								
Vanguard Bond Market	187,760	—	12,844	—	40,717	—	241,321	1.5
Equity:								
Dodge & Cox Int Stock	118,640	—	(35,650)	—	(45)	—	82,945	0.5
Capital World Grth & Inc	37,946	3,954	(9,616)	—	(45)	—	32,239	0.2
Vanguard Ext Mkt Ind	194,864	—	(53,774)	—	(9,209)	—	131,881	0.8
Legg Mason Opp Trust	6,273	—	(2,428)	—	—	—	3,845	—
Growth Fund of America	48,027	9,226	(16,307)	—	69,384	—	110,330	0.7
Alliance Bern with App St	4,201	—	(1,326)	—	—	—	2,875	—
Mutual shares	448,074	1,095	(100,543)	—	(62,231)	—	286,395	1.8
Windsor II Adm	317,047	1,519	(79,962)	—	(61,694)	—	176,910	1.1
Vanguard Inst Index	263,201	22,091	(70,217)	—	1,065	—	216,140	1.3
Vanguard Total Int'l Stock	347,733	334	(106,503)	—	(20,600)	—	220,964	1.4
	<u>1,786,006</u>	<u>38,219</u>	<u>(476,326)</u>	<u>—</u>	<u>(83,375)</u>	<u>—</u>	<u>1,264,524</u>	<u>7.8</u>
Total investments	12,456,792	6,622,791	(180,839)	—	(3,210,440)	—	15,688,304	97.5
Other plan net assets	<u>1,217,996</u>	<u>(810,978)</u>	<u>692</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>407,710</u>	<u>2.5</u>
Total plan net assets	<u>\$ 13,674,788</u>	<u>5,811,813</u>	<u>(180,147)</u>	<u>—</u>	<u>(3,210,440)</u>	<u>—</u>	<u>16,096,014</u>	<u>100.0%</u>

(4) Plan Administration

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

**SOUTH DAKOTA RETIREMENT SYSTEM
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June 30, 2009

(5) Federal Income Tax Status

The Plan is a qualified plan under Section 401(a) of the Internal Revenue Code and is exempt from Federal income taxes. The Plan has received a favorable determination letter dated October 28, 2004. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

(6) Transfers from Related Plan

During the year, no assets were transferred into the Plan from the South Dakota Retirement System Supplemental Retirement Plan (SRP), a related plan. Transfers between SPP and SRP are allowed under state statutes.

(7) Plan Termination

Although they have not expressed any intent to do so, the South Dakota Retirement Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants would continue to be 100% vested in their account balances.

**SOUTH DAKOTA RETIREMENT SYSTEM
SPECIAL PAY PLAN**

Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed In Accordance
with *Government Auditing Standards*

June 30, 2009



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**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Trustees
South Dakota Retirement System
Special Pay Plan:

We have audited the financial statements of South Dakota Retirement System Special Pay Plan (the Plan) as of and for the year ended June 30, 2009, and have issued our report thereon dated November 16, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of basic financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



This report is intended solely for the information and use of the Board of Trustees, state of South Dakota Department of Legislative Audit, and management and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

KPMG LLP

Omaha, Nebraska
November 16, 2009